County of Los Angeles
CHIEF EXECUTIVE OFFICE
Kenneth Hahn Hall of Administration
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WILLIAM T FUJIOKA
Chief Executive Officer

ADOPTED
BOARD OF SUPERVISORS
COUNTY OF LOS ANGELES

13 OCTOBER 12, 2010

Sachi A. Hamai
SACHI A. HAMAI
EXECUTIVE OFFICER

October 12, 2010

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Supervisors:

REPLACEMENT BENEFITS PLAN
(ALL SUPERVISORIAL DISTRICTS)
(3 VOTES)

SUBJECT

This letter and the accompanying ordinance make technical changes to the County Code necessary to preserve the tax-qualified status of the retirement benefits provided to County employees under the County Employees' Retirement Law of 1937 (commonly known as the "1937 Retirement Act"). These recommendations establish a "Replacement Benefits Plan" that compensates retirees for the difference, if any, between the benefits an individual may earn under State law and the maximum benefits that may be paid from a qualified retirement plan under Federal tax law. This arrangement is permitted by the Internal Revenue Code for government retirement plans, and required by the 1937 Retirement Act.

The Replacement Benefits Plan will replace previously approved and now obsolete forms of replacement benefit plan known as "General Member Plan F" and "Safety Member Plan F," respectively. Both versions of Plan F were approved by your Board in 1989, and both will be repealed with the approval of these recommendations. All of these changes are necessary to comply with State and Federal law. None of them enhance any existing retirement benefits for active or retired employees, and none of them create any additional retirement benefit costs.

IT IS RECOMMENDED THAT YOUR BOARD:

Adopt the accompanying ordinance implementing the Replacement Benefits Plan and repealing General Member Plan F and Safety Member Plan F.

PURPOSE/JUSTIFICATION OF RECOMMENDED ACTION

Background

The County's General and Safety Member retirement plans are what are commonly known as tax-qualified defined benefit pension plans. "Tax-qualified" for this purpose means the plans are designed and operated within certain parameters set out in Federal law – the Internal Revenue Code specifically. Compliance with the Internal Revenue Code results in the deferral of any taxation on these benefits until a member actually retires and begins receiving benefits from the Los Angeles County Employees Retirement Association (LACERA). Failure to comply with the Internal Revenue Code would mean loss of this tax-deferred status. Noncompliance is, therefore, not an acceptable option.

Section 415 of the Internal Revenue Code is especially important. This section, which was adopted in 1974, includes a number of key requirements for tax-qualified pension plans. These include, among other things, a requirement that the pensions provided not exceed certain stated maximums that vary based on an individual's age at the point of retirement and whether he is retiring from a law enforcement or firefighter occupation as defined in Section 415 (referred to in the language of Section 415 as a "qualified policemen, firefighter, or emergency medical services worker"). For purposes of this letter, we will refer to this group as "Safety Members" and all other employees as "General Members." (Note: The category of Safety Members for Section 415 purposes is not exactly the same as the category of employees designated as "Safety Members" under LACERA.)

There is, as a practical matter, one Section 415 limit for General Members and another for Safety Members. These are calendar year limits that are adjusted each year (i.e., indexed) based on movement in the Consumer Price Index. The limit for General Members varies by age at the point of retirement with actuarially reduced limits for members retiring before age 62. The limit for Safety Members is not actuarially reduced for members under age 62. In short, compared to the limit for General Members, the limit for Safety Members provides for higher benefits at lower ages. A schedule showing the 2010 limits by age and occupational category is included in the Attachment.

Potential Conflict Between State and Federal Law

Where public sector pension plans are concerned, the limits established by Section 415 may create a conflict between State and Federal law. This occurs where the benefits authorized and protected by State law are greater than the maximum tax deferred benefits permitted under Section 415. In the County's case, for example, a conflict may occur between the benefits promised to employees under authority of the 1937 Retirement Act, and Section 415. Moreover, pension benefits promised to public employees are subject to certain Constitutional protections which cannot be abrogated by Section 415 or any other State or Federal statute.

To address these issues, the Congress has amended Section 415 over the years to provide for two special provisions for State and local government-sponsored pension plans:

- **"Grandfathering":** Under the terms of Section 415 as amended in 1988, individuals who became covered by a public sector pension plan prior to January 1, 1990, may be exempt from the Section 415 limits. However, this exemption applies only to pension plan terms in place as of October 14, 1987. Any benefit improvements made after that date are not covered by this exemption. In the case of Los Angeles County, the grandfathering treatment applies to the retirement plans known as "General Member Plan A" and "Safety Member Plan A." These plans have been closed to new hires for more than 30 years and there have been no changes in the plans that interfere with the application of the grandfathering rules.

- **"Qualified governmental excess benefit arrangements":** Section 415(m) was amended in 1996 to permit government employers to establish qualified excess benefit arrangements as a means of providing promised retirement benefits that a) exceed the Section 415 limits, and b) are not eligible for the aforementioned grandfathering. A qualified governmental excess benefit arrangement is a completely separate benefit plan that works in tandem with a qualified pension plan to cover any gap that may exist between the benefits provided by the qualified pension plan and the maximum benefits otherwise allowed under Section 415.

A qualified governmental excess benefit arrangement must be separately administered and separately funded from the underlying qualified pension plan. Under the proposed arrangement, however, the separate funding requirement will not result in additional pension costs over and above the costs that would otherwise be incurred in the absence of the Section 415 limits. This is because the benefits paid from the Replacement Benefits Plan will correspond with an equal and offsetting reduction in the benefits paid by LACERA. Complete benefit cost neutrality will be achieved in this case because the cost of benefits provided by the Replacement Benefits Plan will be offset by an equal amount being credited against the monthly employer contributions the County would otherwise pay to LACERA to fund retirement benefits.

Qualified Governmental Excess Benefit Arrangement Needed for County Plans

With the exception of General Member Plan A and Safety Member Plan A (which are grandfathered), all of the County's pension plans offer the potential to provide benefits in excess of the Section 415 limits. This includes the plans known as "General Member Plans B, C, D, and E" and "Safety Member Plan B." Although it is a relatively rare circumstance, pension benefits exceeding the Section 415 limits can and will occur in cases where an employee works a very long career with a single public employer, such as the County. Up to now, there have been no benefits owed to any LACERA retiree in excess of the Section 415 limits, but LACERA informs us that this circumstance will soon change.

General Member Plans B, C, and D and Safety Member Plan B have been amended subsequent to October 14, 1987, and those changes make them ineligible for the grandfathering treatment under Section 415. The amendment, in each case, took the form of a change in the earnings period used to calculate the benefits provided under each of the plans (i.e. the "final compensation period"). This period was changed from three years to one year pursuant to the fringe benefit collective bargaining agreements completed and approved by your Board in 2002. Given these facts, a qualified governmental excess benefit arrangement is necessary to protect the benefits earned by and promised to the employees covered by these plans.

A qualified governmental excess benefit arrangement is also necessary for Plans D and E, and Safety Plan B because they continue to be open to new hires. In fact, these plans have been the only plans open to new hires for approximately 30 years. Under the terms of Section 415, grandfathering is not available to any employee/retiree hired subsequent to the aforementioned grandfathering cutoff date of January 1, 1990. Therefore, any public sector plan that is an open plan is a situation in potential need of a qualified governmental excess benefit arrangement. To address all of these needs, the Legislature has effectively mandated the establishment of qualified governmental excess benefit arrangements for California public sector pension plans.

Qualified Governmental Excess Benefit Arrangement Required by the 1937 Retirement Act

Los Angeles County is in a group of twenty California counties covered by the 1937 Act, which is set out in the California Government Code beginning with Section 31450. Section 31899.4 of the Government Code requires participating counties to establish a "replacement benefits program" that preserves the benefit levels of employees and retirees who would otherwise have their retirement benefits limited by Section 415. This applies to employees hired both before and after January 1, 1990, without regard to whether there have been benefit changes subsequent to October 14, 1987. Thus, the California Legislature has mandated the implementation of qualified governmental excess benefit arrangements in counties subject to the 1937 Retirement Act. The Legislature has also taken similar action with regard to public entities covered by the Public Employees Retirement System (PERS).

Consistent with the requirements of Section 31899.4, we are recommending the establishment of the Replacement Benefits Plan as detailed in the accompanying ordinance. The proposed plan is a defined benefit plan that will be administered and funded separately by the County as required by Section 415, but at no additional cost for the benefits in question. It will meet all of the requirements of both State and Federal law and will guarantee no loss of promised pension benefits for any LACERA member due to the limitations of Section 415.

Elimination of General Member Plan F and Safety Member Plan F

In 1989, before Section 415 was amended to permit excess benefit arrangements, your Board approved an early form of replacement benefits plan that is not now compliant with Section 31899.4 of the Government Code. This action produced two separate defined contribution plans known as "General Member Plan F" and "Safety Member Plan F." These plans are currently set out in Chapter 5, Appendix 2 and 3 of the County Code. They were intended to be defined contribution plans administered by LACERA (rather than the County) and were designed exclusively for new hires who became members of LACERA on or after the grandfathering cutoff date of January 1, 1990. As with the proposed Replacement Benefits Plan, these plans were intended to be cost neutral.

General Member Plan F and Safety Member Plan F were never activated or funded as they have never been needed. They do not satisfy the requirements of either Section 31899.4 or Section 415(m), and are effectively obsolete. Moreover, Section 31899.4 specifically requires that Los Angeles County eliminate these plans as a condition of implementing a Section 415 compliant replacement benefits plan. Therefore, we are further recommending that General Member Plan F and Safety Member Plan F be repealed concurrent with the implementation of the proposed Replacement Benefits Plan.

Implementation of Strategic Plan Goals

This recommendation supports the County's Strategic Plan goals of Organization Effectiveness and Fiscal Responsibility by ensuring the County continues to comply with Federal tax law.

FISCAL IMPACT/FINANCING

The proposed Replacement Benefits Plan will not enhance any existing pension benefits for County employees and will not generate any additional costs for pension benefits. Any benefits provided by the Replacement Benefits Plan will be funded from an offsetting credit against the monthly employer contributions the County would otherwise pay to LACERA.

Although there will be no increase in the cost of pension benefits, per se, the proposed Replacement Benefits Plan will be administered by the County with certain assistance from LACERA as explained below. This may, over time, generate indeterminate, but minor administrative costs. There are no measurable costs at this time.

FACTS AND PROVISONS/LEGAL REQUIREMENTS

The proposed Replacement Benefits Plan will be administered through a collaborative effort on the part of LACERA, the Auditor-Controller, and the Chief Executive Office. LACERA will identify the individuals who are entitled to benefits under the Plan, calculate the precise amounts due on a monthly basis, transmit the pertinent information to the County, and perform related record keeping, communication, and customer service activities. The Auditor-Controller will prepare and process all disbursements under the Plan based on information received from LACERA, apply the necessary credit against employer contributions to LACERA (that will fund the Plan), comply with all tax withholding and reporting requirements, and maintain related records.

The Chief Executive Office will serve as the overall Plan Administrator. The Chief Executive Office, in conjunction with LACERA and the Auditor-Controller, may establish procedures regarding the coordination of LACERA benefits and Replacement Benefits Plan benefits so as to minimize disruption to the affected employees and promote the most seamless program possible. The Chief Executive Office, in conjunction with LACERA and the Auditor-Controller, may also make future changes/adjustments in the functions performed by each department/entity where such changes would improve administration of the Plan or create other efficiencies.

The Chief Executive Office has vetted this proposal thoroughly with LACERA and Auditor-Controller staff, and both organizations fully support these recommendations. The Chief Executive Office has also consulted with SEIU Local 721 and the Coalition of County Unions regarding the recommendation contained herein. Neither group has expressed any opposition.

IMPACT ON CURRENT SERVICES (OR PROJECTS)

None.

The accompanying ordinance, which has been approved as to form by County Counsel, requires two readings and shall take effect immediately upon passage.

Respectfully submitted,

WILLIAM T FUJIOKA
Chief Executive Officer

WTF:BC:JA
WGL:WW:mst

Attachment

c: Executive Office, Board of Supervisors
County Counsel
Auditor-Controller
Los Angeles County Employees Retirement Association

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ATTACHMENT

Los Angeles County Employees Retirement System
Internal Revenue Code Section 415(b) Retirement Benefit Limit for 2010 [1]

Age	Annual Limit LACERA Plans B - D	Annual Limit LACERA Safety Plan B	Annual Limit LACERA Plan E [2]
50	$87,978	$195,000	
51	$93,596	$195,000	
52	$99,648	$195,000	
53	$106,174	$195,000	
54	$113,216	$195,000	
55	$120,826	$195,000	$120,826
56	$129,047	$195,000	$129,047
57	$137,927	$195,000	$137,927
58	$147,544	$195,000	$147,544
59	$157,973	$195,000	$157,973
60	$169,301	$195,000	$169,301
61	$181,616	$195,000	$181,616
62	$195,000	$195,000	$195,000
63	$195,000	$195,000	$195,000
64	$195,000	$195,000	$195,000
65 [3]	$195,000	$195,000	$195,000

[1] The Section 415(b) annual benefit limit may be adjusted by the IRS annually for cost-of-living adjustments.

[2] The minimum retirement age for LACERA Plan E is 55 years old.

[3] The dollar limit for the annual benefit is higher if retirement occurs after age 65.